IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MYLES STEWART, Trustee of the Estate of ARTHUR PEABODY and OLIVE PEABODY,

Appellants,

vs.

PHOENIX TITLE & TRUST COMPANY,

Appellee.

No. 18,819

On Appeal From the United States District Court for the District of Arizona

BRIEF FOR APPELLEE

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406 North Church,
Tucson, Arizona.

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CROSS-APPELLANT'S CITATIONS

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JURISDICTIONAL STATEMENT

Appellees agree that this is an appeal from an Order entered on March 29, 1963, affirming in part the Order of the Referee in Bankruptcy entered on May 31, 1962.

Jurisdiction of the Referee in Bankruptcy is under the provisions of Title 11 Bankruptcy Sec. 11(a)(7) United States Code, that of the District Court und and by virtue of the provisions of Title 11 Bankruptcy Section 11(a)(10) United States Code and that of this Court under Title 11 Bankruptcy Section 47 United States Code.

STATEMENT OF THE CASE

Appellee under his brief as appellant in the case of Phoenix Title & Trust Company, Appellant, v. Arthur Peabody and Olive Peabody, Appellees, limited their presentation to the specification of errors set forth on page 9 and the questions presented on page 10 of said brief. Myles Stewart, Trustee, Appellant, in the specification of errors set forth on page 10 of the Appellant's brief attempts to reverse the District Court's ruling under Sec. 70(e) of the Bankruptcy Act. Since the arguments go beyond this specification of error and attempts to answer in anticipation Phoenix Title and Trust Company Appellant's brief, in this brief it will be necessary in addition to the proposition that Sec. 70(e) of the Bankruptcy Act is not applicable in the present situation to discuss matters raised in Appellant Phoenix Title and Trust Company's brief when absolutely necessary to answer Appellant Stewart's brief.

FACTS IN THIS CASE

Appellee incorporates by reference the Statement of the Case of Phoenix Title and Trust Company Appellant's brief covered on pages 2 through 8 thereof. It further accepts Appellant Stewart's Statement of Facts set forth on page 3 through 9 thereof where they are statement of facts, but denies specifically Appellant's interpretation of the intentions of the parties or their conclusions growing out of the instruments and the actions involved.

Appellee, Phoenix Title and Trust Company, specifically denies the allegation on page 4 to the effect Arthur Peabody and Olive C. Peabody were in possession and control of the property at the time of bankruptcy with all powers of management, charged with full responsibility for the handling of the property in carrying out the stated

purposes of the trust, alleging that there is no evidence to support that statement, specifically alleging that all evidence was to the effect that at all times since June 1, 1957, Phoenix Title and Trust Company was in sole and exclusive possession of all the property described in the Trust Deed. (lines 1 through 4, page 72, TR)

With reference to the allegation on page 4 of Apellant Stewart's brief that neither the Trust Deed nor the Trust Agreement refer specifically to other instruments executed by the Peabodys as security, this is denied and Appellee specifically alleges that both documents provide for such contingencies all as set forth in detail in Phoenix Title and Trust Company Appellant's brief.

The Appellee specifically denies the first paragraph on page 5 and believes that the Appellants have stated their conclusions and wishes but that the facts and the simultaneous execution of all instruments force one to the opposite conclusions.

ARGUMENT

Cross-appellant, the Trustee in Bankruptcy, appeals from the Order on Review of the District Court of March 29, 1963, (TR 171) and in his brief (p. 10) specifies that the District Court erred in not sustaining paragraphs 11 and 13 of the Referee's Conclusions of Law (TR 134). By these conclusions the Referee determined (1) that the Trustee in Bankruptcy under Sec. 70(e) of the Bankruptcy Act could be subrogated to the position of the United States as a creditor under its tax lien (notice of which was recorded subsequent to recordation of the Trust Deed, (Exhibit 2), and (2) that the lien of Phoenix Title and Trust Company is inchoate and that applying the doctrine of choateness of lien referrable to the enforcement of Federal tax liens the Trustee, so subrogated, could set aside the asserted inchoate lien

of Phoenix Title and Trust Company.

The argument of Cross-appellant, the Trustee in Bankruptcy, does not substantiate the above-described action of the Referee with respect to Conclusions of Law 11 and 13; rather, Cross-appellant cites cases illustrating the doctrine of choateness of lien but confuses this doctrine with assertions that Cross-appellee's mortgage lien is *"an inchoate transfer"* and that Cross-appellee's *"instruments were inchoate" and unperfected under Section 6323 of U. S. Internal Revenue Code."* Accordingly, Cross-appellant's argument has nothing to do with the action of the Referee as reflected in Conclusions 11 and 13, so that for purposes of clarity Cross-appellee, Phoenix Title and Trust Company, will first answer the general assertion that the Referee's action as reflected in Conclusions 11 and 13 was correct, and will next answer Cross-appellant's argument which appears to assert defects in the recording of Cross-appellee's lien, which, if true, would vitiate Phoenix Title and Trust Company's lien under Section 70(c) of the Bankruptcy Act rather than under Section 70(e) of that Act.

I
TAX LIEN ASPECTS

The Referee erred in his Conclusions of Law 11 and 13 in subrogating the Trustee (under Sec. 70(e) of the Bankruptcy Act) to the position of the U.S. as a tax lien holder and asserting the doctrine of choateness of lien to vitiate Cross-appellee's lien for the following reasons:

1. The doctrine of choateness of lien referrable to insolvency statutes and Federal tax liens under the Federal priority statutes is not applicable in situations under the Bankruptcy Act. *U.S.* v. *Cargill,* Cir.

1, 218 F.2d, 556, 558; *In Re Taylorcraft Aviation Corporation,* Cir. 6, 168 F.2d, 808, 97 L.Ed. 47; *U.S.* v. *Sampsell,* Cir. 9, 153 F.2d, 731, 734.

2. The Trustee in Bankruptcy cannot be subrogated (under Sec. 70(e) of the Bankruptcy Act) to the position of a government as a creditor where the laws creating such creditor relationship are specifically intended to benefit only that government and not creditors generally. *In the Matter of F. A. Whitney Carriage Company,* 173 F. Supp. 709; *Silverman* v. *Wedge,* 158 NE 2d, 668.

3. The creditor contemplated by the Subrogation Statute, Sec. 70(e) of the Bankruptcy Act, is a creditor in the conventional sense. By analogy see: *In the Matter of Ben Green, Bankrupt,* D.C. Ala. 124 F. Supp. 481; *U.S.* v. *Gilbert Associates,* 345 U.S. 361; *U.S.* v. *Security Trust and Savings Bank,* 340 U.S. 47.

4. "Applicable Federal Law" as used in Sec. 70(e) of the Bankruptcy Act refers to Federal law involving property rights and not police measures, e.g. *Benner* v. *Scandinavian American Bank,* 131 Pac. 1149; *Arnold* v. *Eastin's Trustee,* 76 SW 855.

A. *The Doctrine of Choateness of Lien*

As an adjunct of the Federal priority statutes (Sec. 3466 Revised Statutes, 31 USCA §191) the doctrine of choateness of lien was established, beginning in 1933 with *New York* v. *Maclay,* 288 U.S. 290 and culminating with *U.S.* v. *Security Trust and Savings Bank,* 340 U.S. 47, in 1950 (with respect to competing liens). In its inception the doctrine was applied to insolvency situations where bankruptcy under the Bankruptcy Act was not involved. Subsequently, the doctrine

has also been regularly applied in cases involving Federal tax liens where bankruptcy under the Bankruptcy Act is not involved.

Past attempts to apply the doctrine of choateness of lien to situations under the Bankruptcy Act have been consistently rejected where Sec. 64—the priority section of the Bankruptcy Act—was involved. Thus, in *U.S.* v. *Cargill,* 218 F.2d, 556, 558, the Court of Appeals for the First Circuit stated:

> "We shall first deal with the Government's contention that the district court was in error when it failed to apply the federal priority statute which gives the Government priority for its claims in the event of a debtor's insolvency and the commission of an act of bankruptcy. *The weight of authority indicates that this statute is not applicable in proceedings in bankruptcy.* 4 Collier on Bankruptcy, 264 and n. 51 (14th ed. 1954); see *Adams* v. *O'Malley,* 8 Cir., 1950, 182 F.2d 925; *United States* v. *Sampsell,* 9 Cir., 1946, 153 F.2d 731; *In re Knox-Powell-Stockton Co.,* 9 Cir., 1939, 100 F.2d 979. *It cannot be assumed that Congress was so illogical and inconsistent as to enact §64 of the Bankruptcy Act, 11 U.S.C.A. §104, entitling the Government only to a fourth priority insofar as its tax claims are concerned and a fifth priority as to certain other debts owed to the United States, if it did not intend that §64 supercede,* insofar as bankruptcy proceedings are concerned, the first priority given to federal claims under §3466." (emphasis supplied) *U.S.* v. *Cargill,* 218 F.2d 556 at 558.

The Sixth Circuit in *In Re Taylorcraft Aviation Corporation,* 168 F.2d 808, 810, held that the doctrine of choateness of lien did apply because bankruptcy was not involved:

> "The case therefore involves the priority of one lien over another, and §3466, R.S., Title 31 U.S.C., §191, 31 U.S.C.A. §191 and §104, Title 11, U.S.C., 11

U.S.C.A. §104, are not involved. We think the problem is not solved by the citation of the decision of the *United States Supreme Court in New York* v. *Maclay,* 288 U.S. 290, 53 S.Ct. 323, 77 L.Ed. 754; *United States* v. *Texas,* 314 U.S. 480, 62 S.Ct. 350, 86 L.Ed. 356; *Illinois* v. *United States,* 328 U.S. 8, 66 S.Ct. 841, 90 L.Ed. 1049; and *United States* v. *Waddill, Holland & Flinn, Inc., supra. These cases did not involve bankruptcy proceedings, and therefore the priority provision of §3466 was applicable to these decisions.*" (emphasis supplied.)

The leading case rejecting the doctrine of choateness of lien is *U.S.* v. *Sampsell,* Cir. 9, 153 F.2d 731. At page 735 the Court stated:

"Section 64 does not give taxes of the United States or of a state priority of payment over *valid existing liens under §67, since such liens are not affected by the Bankruptcy Act.* Section 67 applies against the United States just as it does against any creditor. A lien does not have to be specific or perfected lien to come within the protection of §67. The cases which have held that only perfected liens are given priority are within the §3466 of the Revised Statutes, 31 U.S.C.A. §191, but that section does not apply to bankruptcy proceedings, hence its all-inclusive effects do not cover the situation in this case." (emphasis supplied)

The only case where bankruptcy was involved and where the doctrine of choateness of lien was applied is *U.S.* v. *Reese,* Cir 7, 131 F.2d 466. The Ninth Circuit specifically overruled that case stating:

"The cases cited by the government, with the exception of *United States* v. *Reese,* 7 Cir., 1942, 131 F.2d 466, do not involve bankruptcy proceedings and hence are not applicable in the instant controversy. It has been established that §3466 of the Revised Statutes, 31 U.S.C.A. §191, does not apply in the bankruptcy proceedings so that the cases cited by the government, in holding that inchoate liens will

not defeat the priority of the government's liens established by that section, do not control the instant case." (pg. 734)

"The case of *United States* v. *Reese,* 7 Cir., 1942, 131 F.2d 466, is not controlling here, since there was a failure in that case to consider the applicable provisions of the Bankruptcy Act, the governing statute, and also because it relies upon authorities which are inapplicable under the Bankruptcy Act." *U.S.* v. *Sampsell,* 153 F.2d 731, 735.

Section 67 protects valid existing liens even though they be not specific or perfected if they otherwise meet the requirements of §67. By implication this case also would reject the possibilities of subrogating the Trustee to the position of the United States as a tax creditor under §70(e) because to do so would then deny the protection of §67 which the Court of Appeals for the Ninth Circuit declares protects liens otherwise meeting its requirements even though they be not specific or perfected.

A moment's reflection on the history of the Bankruptcy Act will show that the Sampsell case governs §70(e) of that Act as well as §64 wherever Federal tax liens are involved:

Sec. 63 of the Act of 1800: "That nothing contained in this act shall be taken, or construed to invalidate or impair any lien existing at the date of this act . . ." *Sec. 2 of the Act of 1841:* ". . . and provided also, that nothing in this act contained shall be construed to amend, destroy, or impair . . . any liens, mortgages, or other securities or property, real or personal, which may be valid by the laws of the States respectively."

With respect to the above quoted sections of the earlier law, *Colliers,* 14th Edition, Vol. 4, page 37, states:

"*Section 67d of the Act of 1898 was intended to be*

a savings clause, serving the same function as §63 of the Act of 1800 and the proviso of §2 of the Act of 1841." (empahsis supplied)

The dissenting opinion of Justice Frankfurter in the recent case of *Simonson* v. *Granquist* (while rendered in connection with facts completely unrelated here) summarizes the status of the lien in Bankruptcy as follows:

> "Congress has thus treated liens as outside the policy of equal treatment of creditors in bankruptcy. 3 Collier supra, ¶57.07. A lienor does not hold simply a first priority; he has "a right to enforcement independent of bankruptcy." id., ¶64.02, at 2061. The Bankruptcy Act deals with the distribution of unencumbered assets among unsecured creditors. id., ¶60.01. Lienholders need no Bankruptcy Act. Liens are independent of and essentially unaffected by bankruptcy proceedings." *Simonson* v. *Granquist*, 369 U.S. 38; 62-1 USTC #9298 at 83,770

From the foregoing the conclusion, inescapably, must be just as §67(d) in the Sampsell case protected a valid existing lien from the priority operation of §64 of the Bankruptcy Act as respects taxes just as much does §67 protect valid and existing liens from the tax lien choateness of lien doctrine asserted through subrogation under 70(e). If the court in Sampsell refused to allow the use of that doctrine through §64 to destroy otherwise valid and existing liens, what compelling reason suggests that it would allow the same thing through §70(e)?

Parenthetically, it should be noted that if the Referee is correct in applying the doctrine of choateness of lien through Sec. 70(e) of the Bankruptcy Act, his Conclusion of Law No. 14 (TR 134) upholding the mechanic's lien of Midway Lumber Company which is clearly inchoate (not having been reduced to judgment—*U.S.* v. *White Bear Brewing Company*, 350 U.S. 1010) is incorrect. Carried to its logical conclusion, if

the Trustee were permitted to assert the doctrine of choateness of lien through §70(e) of the Bankruptcy Act, he would would then be able to avoid any statutory mechanics' liens valid under Sec. 67(d) by using Section 70(e) which doesn't merely relegate the lien under attack to an inferior position by its terms but has the unique effect of opening up the entire field, setting aside entirely the liens of all such creditors, if it can be utilized. Other statutory liens such as mortgages securing future advances on crops, etc., as authorized by 33-773 Arizona Revised Statutes would be vitiated, together with open-end real estate mortgages as now protected under Arizona law; *Griffith* v. *State Mutual Building and Loan Association,* 46 Ariz. 359. Thus, it is conceivable that a $1 Federal tax lien could destroy the entire security of a $5,000,000 shopping center if Section 70(e) could be applied as is urged in this case by the Trustee and ordered by the Referee.

B. *The Trustee may not be subrogated under §70(e) to the position of a government as a creditor.*

An attempt similar to the ruling made in this case, using §70(e) of the Bankruptcy Act, occurred in Massachusetts when the Referee subrogated the Bankruptcy Trustee to the position of the State of Massachusetts as a creditor for corporate taxes to void a prior chattel mortgage.

The United States District Court for Massachusetts held:

> "Even if it could be held that the Massachusetts statutes covered a mortgage transaction I still do not feel that the Trustee could succeed to the rights of the Commonwealth of Massachusetts where that right was granted only to the Commonwealth. To give it the effect that the Trustee seeks would do great harm to our economic system. It is not enough

to say that the language of both Acts is clear and unambigious and that the Court should not attempt to legislate, but should merely apply the laws as found. This is true of course, but the Court should take a realistic view of the purposes intended to be accomplished by both the Massachusetts Laws and the Bankruptcy Act and should apply common sense in reaching its decision."

In the Matter of F. A. Whitney Carriage Company 173 F. Supp. 709 at page 711 (Nov. 30, 1953)

Five-and-a-half years later the same proposition with the same Massachusetts tax law was raised in an attempt to set aside a truck sale; the Massachusetts Supreme Court held:

"The decision then indicated that, even if §76 was applicable at all, 11 U.S.C. (1952) §110, sub. e(1) (11 U.S.C.A. §110, sub. e(1) did not in fact apply to §76, for the reason that the latter was intended to give the Commonwealth a peculiar right which a trustee in bankruptcy was not empowered to assert for the benefit of general creditors. In Matter of F. A. Whitney Carriage Co., D.C. 173 F. Supp. 709." (§76 refers to the Mass. corporate tax law)

Silverman v. *Wedge,* 158 N.E.2d, 668 at 669 (May 18, 1959)

C. *The creditor contemplated by §70(e) is the conventional creditor.*

The conventional creditor under §70(e): The position of the creditor to which the Trustee in Bankruptcy may be subrogated is obviously by Federal law intended to be a *creditor in the conventional* sense. Some indication of this proposition exists *In the Matter of Ben Green, Bankrupt,* D.C. Ala. 124 Fed. Sup. 481; in construing a "judgment creditor" under the protection of the Internal Revenue Code where a Trustee in Bankruptcy attempted to distribute a bankrupt's estate to the State of Alabama

by avoiding the government's lien for Federal taxes, the court held that the State Department of Industrial Relations of Alabama was not a "judgment creditor" as contemplated within the protection of the Internal Revenue Code. The court at page 481 stated that:

> "Judicial gloss placed upon the words 'judgment creditor' as employed by Congress in Sec. 3672 (predecessor to Sec. 6323 of the present Act) conclusively establishes that such words were used "in the usual, conventional sense of a judgment of a court of record'; United States v. Gilbert Associates, at 345 US 361, United States v. Security Trust and Savings Bank at 340 US 47."

With respect to these last two cited cases the court in the Green cases said:

> "Concededly, neither of these cases was dealing with bankruptcy. If the trustee in bankruptcy in the instant proceeding (*wherein there is no conventional judgment creditor to whose rights the trustee would succeed by operation of Section 70, sub. e* of the Act) is endowed with the status of a judgment creditor, it must be because of the provisions of Section 70, sub c of the Bankruptcy Act . . .," (emphasis supplied) "No one may doubt the authority of Congress to constitute a trustee in bankruptcy a judgment creditor with reference to federal tax laws. Clear and appropriate language to that end might have been included in Section 70, sub c of the Act, but obviously was not. Or, Congress might have added trustees in bankruptcy to the categories of persons described in 26 U.S.C.A. §3672(a), as against whom the lien created by 26 U.S.C.A. §3670 is invalid until notice thereof has been filed by the collector as required by law, but it did not. *Nor did it include the trustee in bankruptcy in the corresponding section 6323* of the Internal Revenue Code of 1954, . . ." (emphasis supplied)
>
> *Matter of Green*, 124 F. Supp. 481, 482

From the foregoing *italicized* portion of the

Green opinion, it will be seen that the court before ruling on the contention of the Trustee that it was a "judgment creditor" protected under the tax laws, first considered the possibility of subrogating the Trustee under Sec. 70(e) of the Bankruptcy Act but rejected the State Department of Industrial Relations as subrogee because it was not a conventional creditor under the meaning of Section 70(e).

D. *Applicable Federal Law*

Section 70(e) of the Bankruptcy Act makes void against the Trustee "a transfer . . ., which under any Federal or State law applicable thereto, is . . . voidable . . . by any creditor of the debtor." There are no cases, apparently, applying "applicable federal law." Logic compels that the statute means Federal law equivalent to state law (as in the District of Columbia and U. S. Territories) and that such Federal law defines property rights in the same manner as "applicable state law" applies to creditors; such creditors in each case have property rights—assignable, transferable property rights —which they seek to assert as superior to the property rights of others. The Federal government's rights as a mortgagee or other conventional creditor, or the rights of a conventional creditor within the District of Columbia or under maritime laws and the like (see *Benner* v. *Scandinavian American Bank,* 131 Pac. 1149, and *Arnold* v. *Eastin's Trustee,* 76 SW 855, holding bill of sale and mortgage respectively not valid since not recorded in accordance with Federal statute) clearly should fall within the concept:

"federal . . . law applicable thereto."

But the right of the Federal government to collect taxes is not a property right; it is a *police* power and the manner in which it may be asserted, as through the doc-

trine of inchoateness of lien, can scarcely have been contemplated by Congress as an object for subrogation under Sec. 70(e).

II
APPLICABLE LAW

Is there, as asserted by Cross-appellant, a principle of law that an "inchoate transfer" under Federal Law, Sec. 6323 of the Internal Revenue Code of 1954 is voidable under Section 70(e) of the Bankruptcy Act, or is there a principle of law that provides that where instruments are "inchoate and unperfected under Section 6323 of the U. S. Internal Revenue Code," the creditor owning such instruments is not entitled to protection given by Section 6323, Internal Revenue Code to a "mortgagor, purchaser or assignee"; and finally, does the security device of Phoenix Title and Trust Company (represented by the Trust Deed, Exhibit 2, Trust Agreement, Exhibit 3, Promissory Note, Exhibit 4, and Collateral Assignment, Exhibit 5) comply with the laws of the State of Arizona for the recording of instruments so that it is prior to any claim which the Trustee in Bankruptcy may assert under Sec. 70(c) or Sec. 70(e) of the Bankruptcy Act.

A. *Federal Law*

The first two of the above questions asserted by the Trustee in Bankruptcy in his cross-appeal are set forth on page 11 under the category "Federal Law" and it appears to be the position of the Bankruptcy Trustee that the mortgage of Phoenix Title and Trust Company is not entitled to protection under the Bankruptcy Law as a mortgage device unless it constitutes a valid mortgage under Sec. 6323 of the Internal Revenue Code of 1954. In the first place, the Bankruptcy Act and the Internal

Revenue Code are mutually exclusive. If it is the position of Cross-appellant that Phoenix Title and Trust Company, to establish the validity of its lien, must satisfy the Internal Revenue Code definition of a mortgage under Sec. 6323 of the Internal Revenue Code of 1954, by the same token it would logically follow that the Trustee to assert his superior position should be able to qualify as a "judgment creditor" under the protection of the same statute, Sec. 6323, Internal Revenue Code, but attempts in similar cases have failed completely in that respect. See *In the Matter of Ben Green, Bankrupt,* supra.

The Green case sets forth the Federal Court's position that a Trustee in Bankruptcy simply does not come under the protection of Sec. 6323 of the Internal Revenue Code. The reason is, of course, that the Bankruptcy Act and the Federal tax laws are mutually exclusive. Thus, *In the Matter of Fidelity Tube Corp. et al,* 3 S. Cir. 167, Fed. Supp. 402 at page 403 in defining a judgment creditor within the purview of Sec. 3672 (now Sec. 6323) of the Internal Revenue Code the Court quoted with approval the following:

> "In this instance we think that Congress used the words 'judgment creditor' in §3672 in the usual, conventional sense of a judgment of a court of record, since all states have such courts."

Again, the courts have refused to clothe the Trustee in Bankruptcy with other protective benefits of the Internal Revenue Act, such as those of an employee under Sec. 1303 of the Internal Revenue Code as respects the back-pay of relief provisions of that Act. Thus, in *Williamson* v. *United States,* DC Kentucky 1961, 200 F. Supp. 689 at 691, the Court stated:

> "Had the Congress seen fit to include trustees as employees within the meaning of the statute it could

have said so. An employee and a trustee in bankruptcy are two entirely different things."

For the reasons above stated, and as stated in Part I of this brief, the contention that Phoenix Title and Trust Company as a mortgagee does not satisfy the definition of a mortgagee under Sec. 6323 of the Internal Revenue Code of 1954 is completely irrelevant. This is not a case of priority of a Federal tax lien over a mortgage lien; this is a question of a Trustee's rights under the Bankruptcy Act against a mortgage lien, and historically the Federal Courts have refused to clothe the Trustee in Bankruptcy with any more powers than given him under the Bankruptcy Act. Heretofore, no Court has recognized the contention that the Trustee in Bankruptcy may be impressed with superior powers arising under other Federal statute than those under the Bankruptcy Act, whether it be the Internal Revenue Code, the Federal Insolvency Statutes or any other section of the Federal Code. Logically, "federal law" to which Sec. 70(e) of the Bankruptcy Act refers in determining the rights of a creditor to whom the Trustee may be subrogated is federal law in the conventional sense. While Sec. 70(e) of the Bankruptcy Act makes void against the Trustee "a transfer . . ., which under any federal or state law applicable thereto, is . . . voidable . . . by any creditor of the debtor", there are, however, no cases applying "applicable federal law." Logic compels that the statute means federal law equivalent to state law (as in the District of Columbia and United States Territories) and that such federal law defines property rights in the same manner as "applicable state law" applies to creditors.

B. *State Law*

On page 14, Cross-appellant sets forth applicable portions of Arizona Revised Statutes in support of his

position that the Trustee in Bankruptcy may be subrogated to the position of a creditor under State law and under State recording acts avoid the lien of Phoenix Title and Trust Company. With respect to this latter contention, it is basic that if a hypothetical creditor exists as of the date of bankruptcy who could set aside the lien of Phoenix Title and Trust Company, then that lien may be avoided not under Sec. 70(e) but under Sec. 70(c) of the Bankruptcy Act. On the other hand, under Sec. 70(e) of the Bankruptcy Act, if an actual creditor existed as of anytime (as distinct from the date of bankruptcy) the the Trustee may be subrogated to the rights of that creditor as of the time that creditor's lien affixed.

Phoenix Title and Trust Company's position as heretofore set out is that the Federal government with its tax lien is not a creditor within the purview of Sec. 70(e) of the Bankruptcy Act, unless the Federal government is simply regarded as another creditor in the same category as any general creditor, subject to the established doctrine that first in time of recording is first in right; and it is not disputed that the Federal government (TR 133) filed its notice of tax liens (August 19, 1957) subsequent to the recording of the Trust Deed, Exhibit 2, (July 31, 1956) of Phoenix Title and Trust Company (TR 124). Therefore, if the record title of Phoenix Title and Trust Company is good, the Trust Deed having been recorded prior in time to that of any other instrument except Midway Lumber Company's Mechanics Lien (Exhibit 1), then it follows that Phoenix Title and Trust Company's lien is good against all other creditors, including the United States Government, irrespective of whether or not the Trustee is subrogated under Sec. 70(c) or 70(e).

Heretofore, Phoenix Title and Trust Company's brief (filed February 18, 1964) as Appellant under Part B, page 12 and following set forth the reasons and the authorities by which Phoenix Title and Trust Company claims the validity of its lien as of the date of recordation of Exhibit 2, the Trust Deed. The critical instruments involved in this appeal, the Trust Deed, Exhibit 2, Trust Agreement, Exhibit 3, Promissory Note, Exhibit 4, and Collateral Assignment of Beneficial Interest, Exhibit 5, were all executed and delivered concurrently on July 26, 1956. These instruments collectively constituted the security for Phoenix Title and Trust Company's advance of $50,000.00 to Arthur Peabody, the bankrupt. The Trust Deed was recorded on July 31, 1956. Cross-appellant has attempted, without legal authority, to divide these instruments into two categories—the Trust Deed and Trust Agreement being one category, the Promissory Note and Collateral Assignment being the other category, disregarding the fact that all four instruments were executed and delivered concurrently on the same date, to-wit: July 26, 1956. As previously stated, the general rule is that:

> "Where several instruments, executed contemporaneously or at different times, pertain to the same transaction, they will be read together although they do not expressly refer to each other."
>
> Vol. 17A, C.J.S. Sec. 298, Separate writings, page 128, Restatement of Contracts, 237C. *Clark* v. *Levy,* 25 Ariz. 541; 220 Pac. 232.

Substantially the same security device as used in this case was used in *Barringer* v. *Lilley,* 9 Cir. 96 Fed 2d 607, wherein the only recorded instrument was the Trust Deed. In addition, there was a Trust Agreement in the nature of a Contract for the Sale of Real Estate and a Promissory Note. In the instant case, the Peabody Trust

Agreement provided for releases for subdivision development (and was therefore a vehicle for providing the funding for payment of the Promissory Note). The Collateral Assignment set forth the security terms in the same way that the Trust Agreement did in *Barringer* v. *Lilley,* supra, and the instruments collectively in the instant cast were identical to the instruments collectively in *Barringer* v. *Lilley,* except for the separate Trust Agreement in the instant case which provided for releases as a vehicle for funding the repayment of the $50,000.00 Promissory Note. The Court in *Barringer* v. *Lilley,* supra, in effect found that the instruments in that case collectively constituted a mortgage:

> "The fact that Tunney gave a note for $85,000.00 and that the declaration of trust recited that it was to secure payment of the note seem to lead irresistibly to the conclusion that the declaration of trust was regarded as a mortgage."
>
> *Barringer* v. *Lilley,* Cir. 9, 96 F.2d 607 at page 612.

The Court in *Barringer* v. *Lilley* commenting upon the recordation of the Trust Deed, 9 Cir. 96 F.2d 607 at page 613 stated:

> "In either case, the record title in the Title and Trust Company would be sufficient to put all persons on notice that Owens, Dinmore, and Mills did not own the property or that it was encumbered."

Cross-appellant cites Sec. 33-412A of the Arizona Revised Statutes as to the invalidity of unrecorded instruments. In this connection, this Court in *Barringer* v. *Lilley,* 96 F.2d 607 at pages 612-613 in construing Sec. 969 of the Revised Code of Arizona 1928 (now 33-412A) stated:

> "This statute protects creditors and innocent purchasers against an unscrupulous or dishonest owner of record in possession . . . If inquiry was made by the

creditors they would have actual notice of the declaration of trust, else how could Owens explain away the record title in the Title and Trust Company."

"It being established that record title was in the Title and Trust Company, it follows that all creditors were creditors with notice of the fact that Owens and his associates were not owners of the tract, at least so far as the record was concerned—which is notice to all the world."

In the foregoing citation from the Barringer case, this Court has interpreted Sec. 33-412A and by implication has approved recordation of the Trust Deed as being sufficient to comply with requirements of Sec. 33-412A and the Court's conclusion in this respect logically follows, because while the above quoted section provides:

". . . conveyances and deeds of trust shall be recorded."

Yet as quoted by Cross-appellant, Arizona Revised Statutes Sec. 33-702 in defining a mortgage provides:

"Every transfer of an interest in property, *other than in trust,* made only as a security for the performance of another act, is a mortgage, . . ." (emphasis supplied)

So that it appears from the foregoing quoted sections of the applicable Arizona statutes the Arizona legislature did not intend that transfers in trust for security purposes be subject to the same recording provisions as mortgages. On the other hand, a conveyance would fall flatly under Sec. 33-412A which clearly requires the recordation of the Trust Deed, with which there was full compliance in the instant case, the Trust Deed having been recorded on July 31, 1956.

As previously stated and as above quoted, the Court has heretofore held in *Barringer* v. *Lilley,* supra, that

> ". . . record title was in the Title and Trust Company, it follows that all creditors were creditors with notice . . . which is notice to all the world."

The Arizona Supreme Court in *Maricopa Utilities Company* v. *Cline,* 60 Ariz. 209 at page 214, 134 Pac. 2d 156, 158, stated:

> "Notice of facts and circumstances which would put a man of ordinary prudence and intelligence on inquiry is equivalent to knowledge of all of the facts a reasonable diligent inquiry would disclose."

The recorded Trust Deed, Exhibit 2, with its Trust file number, 6007, with its reference to the power of the Trustee to mortgage or pledge the trust property, including mortgage it, to itself, would have lead any reasonable inquirer to the instruments contemporaneously executed with the Trust Deed. For the above set forth reasons, the lien of Phoenix Title and Trust Company having been recorded prior to the lien of any other creditor, except Midway Lumber Company, was superior to all liens recorded subsequent to the Trust Deed and the Trustee in Bankruptcy could not avoid it under Sec. 70(c) or 70(e) of the Bankruptcy Act.

Finally, the Court's attention is directed to *Chicago Federal Savings and Loan* v. *Cacciatore,* Illinois Appellate Court, First Dist. 62-1 USTC 83,361. In this case, by an agreement similar to that between Phoenix Title and Trust Company and Peabody, the taxpayer conveyed all of his interest in certain real property to a Trustee, retaining only a right to reclaim the property, which right, under Illinois law, is deemed to be personal property in the same manner as provided for in the Peabody Trust Agreement. (See paragraph X, page 4 of Exhibit 3) The Trustee, subsequent to the time that the United States recorded notice of its tax liens against the settlor of the trust, executed two mortgages. It was held

that the United States' liens could attach only to the rights of the taxpayer settlor of the trust, which are no more than personal property rights and that the subsequently executed mortgages were valid against the prior recorded Federal tax liens. The Court stated:

> "Thus, state law controls over our conclusion as to the nature of the taxpayer's legal interest in the property sought to be reached, and federal law becomes our guide only in defining the consequences to be attached to such state-created rights by virtue of the federal lien law."
>
> "We cannot agree with the government in this, when to insure the success of such a policy would, as we have held, require upsetting not only long-established principles of state law but also, perhaps, thousands of real estate titles as well." 62-1 USTC 83, 361; p. 83, 365.

Finally, the Court stated at page 83, 364

> "Experience over many years has shown that a land trust performs many commercially useful purposes. It goes far to obviate the cumbersome nature of real estate transactions when there are multiple owners. In the same circumstance, it can simplify the management and financing of real properties and it is especially useful in the financing and marketing of subdivisions and large scale home or apartment building enterprises. Intolerable delays and sometimes insurmountable legal entanglements may result from the death, incompetency or disappearance of an owner of a fractional interest in land. These, too, can be eliminated by the judicious use of a land trust." 62-1 USTC 83, 361; p. 83, 364

III

AUTHORITIES CITED BY CROSS-APPELLANT

The authorities cited by Cross-appellant on page 13 of his brief are not applicable here for two reasons: first,

they do not involve bankruptcy situations; second, they usually refer to statutory liens which are by nature general; thus, in *United States* v. *Knott,* 298 U.S. 544, an insolvent surety company was placed in the hands of state insurance commissioner for liquidation. The Company on commencing business had deposited securities with the State Treasurer as a "trust fund" where the claimants (who could not become known until there had been a default on the part of the company) were not identifiable so that the lien was inchoate. It is quite clear in the instant case that Phoenix Title and Trust Company always was a claimant as distinct from a wide class of possible claimants who were prospective unidentified beneficiaries of a security fund. *United States* v. *Gilbert Associates,* 345 U.S. 361, cited by Cross-appellant is a case involving the priority of Federal taxes over municipal taxes. Bankruptcy was not involved; this was a proceeding under the Federal Insolvency Statutes where the doctrine of choateness of lien determined the superiority of the general tax lien of the Federal government over the general tax lien of the municipality. *United States* v. *Carroll Construction Company,* 346 U.S. 802, was similar to *U.S.* v. *Gilbert* and is a case where the Federal government's tax lien was held superior to the general tax lien of the State of Washington, again by application of the doctrine of choateness of lien under the Federal Insolvency Statutes. *United States* v. *Texas,* 314 U.S. 480, again involved a statutory gasoline tax lien, which lien by statute applied to "all the property of any distributor used in his business"; here the gasoline tax in an insolvency situation was held inchoate for failure to describe in particular the property, subject of the lien, which, of course, is not the situation with Phoenix Title and Trust Company's mortgage lien where the property is particularly described in the Collateral Assignment

and Trust Deed. In *United States* v. *Scovil,* 348 U.S. 218, a landlord's lien was held inferior to a Federal tax lien in an insolvency procedure, representing again a lien against property generally as distinct from property specifically. *United States* v. *Colotta,* 350 U.S. 808, *United States* v. *White Bear Brewing Co.,* 350 U.S. 1010, are two of a series of cases wherein the United States Supreme Court has held mechanic's liens (because they require court proceedings to enforce them) inchoate until judgment is rendered; similary, *United States* v. *Vorreiter,* 355 U.S. 15. None of the cases cited by Cross-appellant involves a bankruptcy situation and the Federal tax liens concerned all deal with general statutory liens inchoate under the Internal Revenue Code. The other cases cited on page 13 of Cross-appellant's brief simply establish the general rule; thus, in *General Motors Acceptance Corporation* v. *Collier,* 106 F.2d 584, it was held that an unrecorded chattel mortgage of an automobile was not prior to the claim of interim creditors giving credit prior to the time that the mortgage was recorded. Similarly, the Sampsell case (*Bank of America* v. *Sampsell,* 114 F.2d 211) wherein it was held an automobile chattel mortgage executed in August 1938 and not recorded until January of 1939 was invalid against an interim bankruptcy. The only case of assistance cited by Cross-appellant is *Joseph* v. *Winakur,* CCA 4, 30 F.2d 510. Here a bill of sale absolute on its face was used as a mortgage and it was held that a failure to record a contemporaneous consignment agreement was fatal under the Mayland statutes which provided:

> "1. Every deed conveying real estate or chattels . . . intended only as security in the nature of a mortgage, though it be an absolute conveyance on terms . . . shall be considered as a mortgage and the person for whose benefit such deed shall be made shall not have any benefit . . . from the recording thereof,

unless every instrument in writing operating as a defense of the same . . . be also therewith recorded." 30 F.2d 510, 513.

This case takes a position opposite from *Barringer* v. *Lilley,* supra. But it will be noted that in that case the Maryland statute *specifically required the recording of all instruments involved in a security transaction,* whereas, under the Arizona statutes it appears that the recording of the Trust Deed is sufficient.

Finally, Cross-appellant on page 16 of his brief quotes the District Court's Order of March 29, 1963 (TR 171) which asserts that the Collateral Assignment (Exhibit 3) of Phoenix Title and Trust Company is no more than an unrecorded chattel mortgage. This contention was answered at length on pages 24-26 of Phoenix Title and Trust Company's Appellant's Brief filed in this cause February 18, 1964, wherein it was established that in defining "mortgageable property the codifiers of the Arizona statutes in adopting the California Code referrable thereto omitted the exception for intangibles."

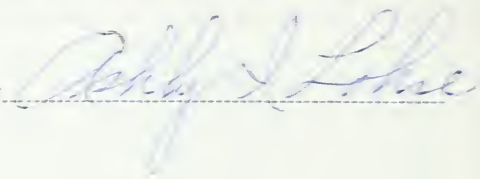
CONCLUSION

From the authorities set forth above, Cross-appellee, Phoenix Title and Trust Company, respectfully submits that the Bankruptcy Act is complete within itself in establishing priorities and that doctrines and statutory right referrable to the Internal Revenue Code or statutes other than the Bankruptcy Act may not be superimposed upon the Bankruptcy Act in determining the rights of the Trustee in relation to the rights of creditors with liens, and that the security instruments of Phoenix Title and Trust Company, Exhibits 2, 3, 4 and 5, together constitutes a valid mortgage under the doctrine of *Barringer* v. *Lilley,* supra, choate in all respects as defined by the

United States Supreme Court in *United States* v. *City of New Britain*, 347 US 81 at page 84, and perfected in all respects as heretofore announced by this Court in *Barringer* v. *Lilley*, supra.

Respectfully submitted,

LOHSE, DONAHUE & BLOOM

By 

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

NO. 18,819

MYLES STEWART, Trustee of the Estate of ARTHUR PEABODY and OLIVE PEABODY,

Appellants,

vs.

PHOENIX TITLE & TRUST COMPANY,

Appellee.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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By .....

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